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TAGS: ECON EIND KIPR ELAB WTRO CH
SUBJECT: SHANGHAI GM RELATIVELY IMMUNE FROM GM FINANCIAL WOES, BUT
NOT FROM CHINA'S ECONOMIC SLOWDOWN

REF: 07 SHANGHAI 328

SHANGHAI 00000574 001.2 OF 005

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¶1. (SBU) Summary: On December 18, the Consul General (CG) met with Shanghai General Motors (GM) Executive Vice President Robert Socia and other top executives to discuss the effects of the economic downturn, general business environment issues and the local fall-out from GM's financial troubles. Socia said Shanghai GM has suffered little effect from GM's financial turmoil in the United States and the JV will not be used to collateralize any loan from the USG. The economic slowdown in China has decelerated Shanghai GM's sales, but it has not dampened their optimistic outlook on China's growth potential. Although Shanghai GM currently does not have any major intellectual property disputes, GM is still circumspect in bringing some of its most sensitive technology to China. Socia attributed the absence of IP issues and ability to have its voice heard to its "strong" joint venture partnership with Shanghai Automotive Industry Corporation (SAIC). The Central Government is pressuring the auto industry to "green up," and Shanghai GM is moving forward on plans for more environmentally friendly technology. On the recent WTO ruling against China on the auto parts case, Socia said that little will change for Shanghai GM in its sourcing strategy, since cost reduction pressures necessitate local sourcing regardless. End Summary.

Minimal Impact from GM's Financial Troubles

¶2. (SBU) When asked how Shanghai GM, a 50-50 joint venture between General Motors and the SAIC, is affected by GM's financial distress in the United States, Socia replied, "of course there is some effect, but very minimal." He explained that from a financial perspective, Shanghai GM is self-funding and in fact sends dividends home to its U.S. parent. Shanghai GM would also not be part of any collateral used to secure U.S. Government loans. GM is focusing on ensuring that growth areas, such as those in China, continue to grow. Socia declined to predict what would happen to Shanghai GM if GM files Chapter 11 Bankruptcy, but he confided that Shanghai GM does have plans in

place if that were to occur. Socia said SAIC has been very supportive and assured GM it will be there throughout the ordeal.

Sales Slowing, But Shanghai GM Still Optimistic
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¶3. (SBU) Socia said that although Shanghai GM's sales growth rate slightly declined in 2008, he is still optimistic about the future. In 2008, GM initially projected 14.5 percent growth in China over 2007, but actual numbers are showing only nine to ten percent growth over 2007. Market share has also dropped on the margins; in 2007 GM sold 1,031,974 units and held 12.2 percent of the Chinese new automobile market. In 2008, total sales have reached 1,120,762 units (with a few days remaining in the year), or approximately 12.1 percent of the market. According to Socia, August and September were the first two months of negative growth in a long time. In October, there was a little growth, and November sales were off by eleven percent. December is shaping up to be a bit stronger than expected. According to Socia, 2009 will likely not produce double digit growth, but the market will still be in positive territory, especially after China's stimulus package kicks in during the second half of the year.

¶4. (SBU) Socia further downplayed the slowdown in the Chinese market, saying that as a result of slowing sales growth, the company might have to make a "few adjustments" such as delaying the introduction of a new model and delay ramping up from a 2 shift/2 crew schedule to a 3 shift/3 crew schedule. Currently the Shanghai plant is running at only 50 percent capacity, which would be a problem in other regions, but in China with its vast potential, GM leadership is not alarmed. Socia said a little extra capacity is okay, because they know it will eventually be filled. Socia also cited a recent visit to a Shanghai GM show room that was "packed" with people still interested in buying vehicles to bolster his predictions.

¶5. (SBU) Regardless of the recent slowdown, Socia believes China's long-term auto market has vast potential. To make the point, he noted that vehicle density in China is extremely low. China has 24 cars per 1,000 people, compared with 800 cars per 1,000 people in the United States. Continued economic growth and rising personal income in China drive the automotive industry's growth here. In addition, a great deal of market growth is coming from China's tier 2 and tier 3 cities. Socia said GM has adapted GM's products, making them more durable and spartan, to meet the needs of consumers in these cities. According to Socia, the response has been tremendous. Besides auto sales, Socia says GM also sees a great deal of potential in after sales services, used car sales, financing, and insurance. However, the key to tapping these markets lies in GM's relationship with SAIC. GM is so convinced about China's market potential that it opened a new factory in northeastern China on December 17. (Note: The new plant is operated by GM China and its joint venture partners SAIC and Shanghai GM. End note.)

Global Sourcing from China - Down USD 9 Billion
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¶6. (SBU) Socia refrained from commenting on the impact of the global downturn on GM's parts sourced from China since parts are handled by a separate division of GM. However, he said the fall in overall U.S. automobile sales from 18 to 8 million units this year and GM's sales decline therein has definitely hurt Chinese auto parts manufacturers. The downturn in sales did not begin with the financial crisis, but began much earlier in the year as fuel prices soared in the United States. In a separate conversation, GM China's Global Sourcing Account Manager Hugo DeCampos said that automotive components sourced from China for GM's facilities around the world were down from USD 10 billion in its original 2008 forecast to a little under USD 1 billion. DeCampos confirmed there was a slowdown of sourcing from China

that started early in the year from the United States and quickly spread to Europe and other regions. Chinese auto parts manufacturers are really struggling now and some have begun to close their doors.

Shanghai GM's Biggest Challenge: Stiff Competition
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¶7. (SBU) Socia said that as a result of China's enormous auto sales potential, both foreign and domestic automakers are aggressively pursuing the market, which creates fierce competition. This leads to a "great deal of pressure on the pricing side," which will continue for the near future. To illustrate his point, he explained that from January 2004 to April 2008, the average sale price per new auto in China dropped 27.6 percent in real terms. In other parts of the world, GM has been able to marginally raise prices; however, in China price increases are impossible. (Note: China currently has about 100 car manufacturers, of which 11 to 12 produce 80 percent of the total production volume. End note.) Socia said that the only companies that Shanghai GM considers as significant competitors are Toyota and VW. He added that Chery Auto (headquartered in East China's Anhui Province) has "fallen off" his list of worries because it has not done well, and he no longer considers the company a threat. (Note: In a 2007 conversation, GM Shanghai officials described Chery Auto as the only local Chinese company that could produce in significant volume and threaten GM market share. See 2007 reftel. End note.) Despite price pressures, the Chinese are also some of the most sophisticated and demanding auto consumers in the world. Socia noted that in China, the company has had to put more work into their auto interiors than they have in other countries to win customers.

IPR Protection Not an Issue, But Still Cautious
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¶8. (SBU) Socia said that Shanghai GM did not face any significant IPR issues at this time. He attributed this to the "close relationship with SAIC," noting that SAIC helps resolve any IP issue that might come up. However, SGM is still cautious

about bringing some of its more sensitive intellectual property to China. For example, it limits some of the technology it provides to the Pan Asia Technical Automotive Center (PATAC), which is a joint venture
design and
engineering center between General Motors
and
Shanghai Automotive Industry Corporation
founded in 1997. (Comment: While GM may have hesitations about bringing its most sensitive technologies from the United States, it is moving full speed on developing new technologies inside China. In October 2007, GM launched the GM Center for Advanced Science and Research (CASR), part of a new USD 250 million GM corporate campus in Shanghai, which is to be home to GM's operations in China as well as its Asia-Pacific headquarters. The center will carry out advanced research projects in partnership with the Chinese Government, industry partners and academic institutions with a specific focus on energy-efficient and environmentally friendly transportation. This effort is part of GM's strategy of "in China, with China, for China." End comment.)

¶9. (SBU) Socia said GM does not have any problems having its views heard on regulatory issues. It has three channels to make its views known to Chinese regulators: directly, through Shanghai GM, or through SAIC. In Socia's view, the most effective was to work through SAIC because its executives have the best relationships and networks, but sometimes it may utilize all three channels in coordination. He emphasized that GM has a solid relationship with SAIC, and both sides have put a great deal of thought as well as capital into the JV.

China Creating "Green" Pressure for Auto Companies

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¶10. (SBU) The Chinese Government is putting a great deal of pressure on the automotive industry in China to "green up," according to Socia. There is a big push to boost fuel saving technology as well as curb fuel consumption through a fuel tax, consumption tax, and a purchase tax. The Government is adopting Euro IV and Euro V emission standards to improve air quality and is considering recycling regulations for autos. Safety regulations are also being tightened, with higher requirements for roof strength and child restraints. GM Asia Pacific Public Policy Director David Tulauskas added that China is drawing on the top environmental and safety standards from around the world and has accomplished the same regulatory environment in a decade that has taken many western countries fifty to sixty years to develop.

¶11. (SBU) GM's strategy to lead in the "drive to green" in China rests on two pillars - produce more fuel efficient vehicles, and ensure a corporate level "green system," with green social responsibility, according to Socia. Shanghai GM is following GM's trajectory in developing more environmentally-friendly vehicles with the most advanced technology. The company plans to offer a hybrid vehicle in China within the next two years. It is also developing E flex electric vehicles and is on the path to develop and introduce fuel cells with zero emissions. In addition, Shanghai GM ensures that all of its plants in China uphold the strictest environmental standards; its new plant in northeastern China employs state-of-the-art environmental technology. The company also ensures that its 120 suppliers are also "greening up" their own facilities. Socia noted that Shanghai GM has partnered with an environmental protection foundation to identify and fund environmental research projects.

WTO Ruling Against China on Auto Parts Will Change Little
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¶12. (SBU) According to Socia, little will change for Shanghai GM in its sourcing strategy as a result of the WTO ruling against China on the auto parts case. Upwards of 90 percent of the parts used by Shanghai GM are locally sourced. (Note: Shanghai GM sources most of its parts from firms with which it

has joint ventures; most are existing business partners in other countries. End note.) Shanghai GM sourcing may become a bit more flexible, but fierce competition and a relentless push to cut costs in China, rather than the auto parts component rule, forced Shanghai GM to maintain high local content anyway to ensure "just in time delivery" and avoid hefty transportation costs. Also, the quality of most local components is now sufficiently high to meet Shanghai GM's standards. (Note: During a June 2007 visit, Shanghai GM leadership said the content threshold was difficult to reach with new high-end products because components were not available locally. End note.) Tulauskas added that although it is yet to be seen whether China will come out with a new policy on components sourcing, a high level Ministry of Commerce official assured him that if China lost on the WTO auto parts dispute settlement case, China would modify its rules and practices to comply with the WTO ruling.

Labor Turnover Slowing - The Upside to the Downturn
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¶13. (SBU) GM China Group Human Resources Director Shannon DiPietro said that the economic slowdown in China has helped staunch the rapid staff turnover; however she noted that Shanghai GM already had a relatively low turnover rate. The current annual attrition rate is three percent - roughly two percent quit of their own volition and one percent is fired. She attributed this to Shanghai GM's highly competitive pay. Although the JV has not had to lay off any workers, it has taken more precautions in hiring new people, ensuring that every

person added is fulfilling an essential task. According to DiPietro, thus far labor costs have been unaffected by the Labor Contract Law, because Shanghai GM was already following most of the provisions before that law was implemented. However, the law could become more of an issue if an extended downturn necessitates letting workers go. Socia also noted that although Shanghai GM is "unionized," the PRC government-sponsored trade union has little effect on business since the union's emphasis is on "total harmony."

¶14. (SBU) Shanghai GM Manufacturing Director Julian Blisset said that the cost of labor in Shanghai is roughly double that of northeast China, where GM opened a new plant on December 17. He added that the high cost of labor in Shanghai is one of the reasons GM will not expand its manufacturing beyond current operations in the city. The average age of its Shanghai GM workers in Shanghai is around 27 or 28. Absenteeism is less than one percent, the lowest of any GM plant around the world. Only five percent of the workers on the assembly line are female, but this appears to be a self-selection issue. The average education level of a line worker is a high school or technical school diploma. For senior management or engineers there are higher educational requirements. The plant has increasingly "localized" its staff; for example, Shanghai GM currently only has one expatriate production staff member. Since Shanghai GM only focuses on line and general assembly, all other jobs (such as cleaning) are outsourced.

Background

¶15. (SBU) In 1997, GM was one of the first foreign firms to begin producing automobiles inside China by establishing a 50-50 joint venture with SAIC. GM vehicles first rolled off Shanghai assembly lines in 1999. However, the JV experienced slow growth until 2002 when the company saw a large jump in sales after China entered the WTO and the market was liberalized. Shanghai GM soon became the first JV to sell over 500,000 vehicles in China. Shanghai GM now produces several new models each year, and in 2008, it launched a new Excelle, a new CTS and a new Buick Regal. (That last model went on sale in China on December 21.) China is now GM's second largest market after the United States. With the opening of the new plant in northeastern China, GM in China now has eight assembly plants, four power train facilities, an engineering and design center, an automobile financing JV, AC Delco and On Star operations, and a warehousing facility. As part of its strategy of strong network development, the company has also established a wide range of

dealerships that are fully franchised. GM currently has a total of seven joint ventures and 21,000 employees in China, 12,000 of whom are employed at its Shanghai GM JV in Shanghai.
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